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No. 87-915

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1987

GUY F. ATKINSON COMPANY OF CALIFORNIA and SUBSIDIARIES,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITIONERS' REPLY MEMORANDUM

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Respondent fails entirely to respond to, much less to refute, our

* Petitioners' parent companies, affiliates, and non-wholly owned subsidiaries are listed in the Petition (Pet., p. ii).

demonstration that the decision below is fundamentally inconsistent with long-standing principles of tax accounting governing the reporting of outstanding contingent claims (Pet., pp. 10-18). The court of appeals' interpretation of the dispute provisions as inapplicable until the taxpayer has tendered "full performance" under the contract would permit indefinite deferral of tax reporting by taxpayer manipulation of litigation and settlement strategies (Pet., pp. 11-13). The court's decision also improperly makes tax reporting depend on relitigation in the Tax Court of the parties' underlying contract dispute to determine whether the contract was in fact "fully performed" (Pet., pp. 14-18).

Respondent does not dispute any of these central points, which raise issues of broad significance under

numerous defense and other long- term contracts.

In an effort to devise some basis for supporting the judgment below, the Solicitor General instead advances a rationale that the court of appeals expressly rejected. He contends that the dispute provisions were inapplicable because WTC had not "substantially completed" its performance under the contract (Opp., p. 5).

The "substantial completion" test was the basis for the Tax Court's erroneous decision (Pet.App., p. A-24). However, in E. E. Black Ltd. v. Alsup (9 Cir. 1954) 211 F.2d 879, the court of appeals had squarely rejected "substantial completion" as the standard for tax reporting on long-term contracts, on the ground that it would "import into the tax law an unwarranted and undesirable uncertainty" (id. at 880). Thus,

contrary to the Solicitor General's present contention--based on a misleading selective quotation of the court's opinion (Opp., p. 5)--the court of appeals in this case understandably did not rest its decision on the "substantial completion" theory. Instead, the court held that tax reporting requires the taxpayer to tender full contract performance sufficient to "discharge the contractual obligation" and give a right to "full payment" of the contract price, even where all work on the contract has been finally terminated pursuant to a dispute (Pet.App., pp. A-8 to A-9).

Respondent's "substantial completion" standard--like the court of appeals' "full performance" standard--is flatly contradicted by both the language and purpose of the regulations (see Pet., pp. 10-13). Respondent can point to no language in the regulations

supporting its position, which require only that the "taxpayer tender[] the subject matter of a long-term contract" to permit tax reporting (Income Tax Regs., § 1.451-3(d)(2)(i), (3)(i) and (4)(i); Pet.App., pp. A-42, A-46, A-48).

Respondent has also seen fit to resort to repeated misstatements of the governing regulations. For example, respondent asserts that the examples to the regulations all involve cases in which "substantial" performance had been completed (Opp., pp. 5-6), but disregards that in two of the examples the contract performance was obviously not substantially complete (see Pet., p. 14; Pet.App., pp. A-45 to A-46, A-49). Thus, respondent mischaracterizes example 2 to section 1.451-3(d)(4) of the regulations (permitting tax reporting) as involving a "finished office building" (Opp., p. 6), when, in fact,

the buyer demanded that additional work be done in an amount affecting 40 percent of the contract price.

Similarly, respondent argues that the dispute provisions "do not purport to alter the general rule that items not in dispute must be reported in the year in which the contract is completed" (Opp., p. 4) and claims that petitioners do not dispute that the contract was not completed in 1975 (ibid.). These surprising assertions misstate both the regulations and the entire basis upon which this case has been tried. Petitioners have consistently urged that the contract was complete for tax reporting purposes when work under the contract was finally terminated in 1975 and all operational expenses and revenues of the contract were known. The regulations explicitly provide that the general "final

completion and acceptance" standard for tax reporting where there is no dispute is inapplicable where a dispute exists between the owner and the contractor on contract termination (Income Tax Regs., § 1.451-3(d)(1); Pet.App., p. A-42). In such cases, "completion" occurs, for the purpose of tax reporting, when the taxpayer tenders the subject matter of the contract to the owner. In this case, that occurred in 1975.[1]

Respondent's passing contention that petitioners' deduction was in any event improper under section 1.451-3 (d)(2)(ii) of the regulations (see

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1 Respondent incorrectly asserts that petitioners' deduction in 1975 was for an "anticipated loss" (Opp., p. 5). In fact, petitioners' deduction represented their share of WTC's actual operating loss on the project, calculated by taking WTC's actual receipts from the project and deducting its known cost of operations.

Pet.App., pp. A-42 to A-43), because the parties' contingent claims made it impossible to determine whether petitioners would ultimately realize a profit or loss (Opp., p. 6), is also impossible to reconcile with the plain language of the regulations. As demonstrated in the Petition (Pet., p. 6, n.4), section 1.451-3(d)(2)(ii) does not apply to this case. It deals only with cases involving contingent claims from the buyer (in this case, the City) which make it impossible to determine whether a profit or loss will result, not with cases like this involving contingent taxpayer claims. In this case, petitioners were assured of a substantial loss without regard to the City's claim (see Pet., p. 6, n. 4). The Solicitor General has no response to this point, but simply offers the bald assertion that the regulations do not mean what

they say. The Solicitor General's reliance on this obviously mistaken argument--which, once again, provided no part of the court of appeals' rationale[2]--amply illustrates his inability to support the decision below.

Finally, respondent attempts to harmonize the court of appeals' ruling with the Tax Court's leading decisions by asserting that in those cases performance was substantially complete or the year of completion was conceded (Opp., p. 6, n. 1). Respondent ignores that each of those decisions was based on the fact that the contractor's work was finally over (see National

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2 In its initial opinion (Slip Op. (4/15/87), pp. 12-13), the court of appeals had advanced this misreading of the regulations but, on petition for rehearing, it deleted that portion of its opinion.

Contracting Co. v. Commissioner (1938) 37 B.T.A. 689, affirmed (8 Cir. 1939) 105 F.2d 488; A. S. Wikstrom, Inc. v. Commissioner (1969) 28 T.C.M. 143; C. H. Leavell & Co. v. Commissioner (1969) 53 T.C. 426). Moreover, respondent does not dispute that the work in the National Contracting case, in which tax reporting was permitted, had been terminated midstream, just as in this case. The Commissioner's concession of completion in National Contracting despite the clear lack of either substantial or full performance underscores that tax reporting is proper when--as in this case--all contract work is terminated and the taxpayer's actual revenues and expenses from operations are known, despite the existence of unresolved

contingent claims over whether the contract has been fully discharged as a matter of contract law.

Respectfully submitted,

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